

COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

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In Re: Pricing and Procurement of) D.T.E. 99-60

Default Service

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Reply Comments of Sithe New England, Inc.

I. INTRODUCTION

Sithe New England, Inc. ("Sithe") is pleased to have the opportunity to offer its comments in response to the Initial Comments submitted to the Department of Telecommunications and Energy ("DTE" or "Department") concerning its Notice of Inquiry/Generic Investigation into the Pricing and Procurement of Default Service.

As noted in its Initial Comments in this matter, Sithe currently owns and operates approximately 2000 megawatts ("MW") of generation assets in Massachusetts and is proposing to construct and operate an additional 2865 MW of generating capacity in the Commonwealth. As a participant in New England's wholesale electricity markets, Sithe has a substantial interest in the development of a vibrant generation market. Although Sithe's business focus is on wholesale electricity markets, it is important that the Department recognize that the efficiency of the wholesale marketplace is inextricably linked to the efficiency of retail generation markets. Thus, Sithe's comments herein are designed to focus the Department's efforts toward the goal of further developing a competitive wholesale generation market by enhancing competitive opportunities in the retail marketplace.

II. THE ELECTRIC RESTRUCTURING ACT AND THE ADVENT OF COMPETITION

As has been pointed out by many commenters in this proceeding, the advent of retail choice in Massachusetts has not yet resulted in a robust retail electricity market. These commenters have correctly noted that the lack of retail competition can be attributed to a below-market standard offer pricing mechanism. As an interim measure, distribution companies also have supplied retail default customers at the standard offer rate.

For purposes of this investigation, it is important to bear in mind that as part of the Electric Restructuring Act of 1997 ("Restructuring Act" or "Act"), the Legislature implemented two distinct forms of retail electric service to be offered by the incumbent utility -- standard offer service and default service, while at the same time allowing for the provision of retail service to all customers by competitive suppliers.

By their nature, standard offer service and default service each serve a different purpose. Standard Offer service has been established by the Legislature at a specified rate (within certain parameters), which will increase over time, and is anticipated to cease at the end of the Legislatively defined transition period. The Legislature also offered explicit guidance as to the pricing scheme for default service. Similarly, the Legislature has provided ample guidance as to eligibility for each distinct service.

At present, the majority of retail electric customers remain on standard offer service. However, as evidenced by information provided by distribution companies in this proceeding, default service represents an increasing market segment, and can be expected to continue to grow both in the near term and for the remainder of the transition period. At this juncture, the Department has the opportunity to implement a default pricing and procurement policy that will further enhance nascent competitive markets.

1. Default Service and Standard Offer Prices Need Not Be Linked

Standard offer service has been implemented by the Legislature and the Department primarily as a transitional mechanism, and has not been established to represent a market price for electricity. There is no necessary linkage in the Restructuring Act between standard offer and default prices. In fact, the Legislature's intent would appear to be to the contrary. Specifically, the Restructuring Act indicates that default service should be procured at a rate "not to exceed the average monthly market price of electricity." Thus, it is appropriate at this time for the Department (1) to sever any linkage between default and standard offer pricing, and (2) to establish a policy for default service that will align default pricing with market conditions, and, by doing so, further enhance competition.

2. The Need for Market Pricing

Some comments have suggested that a continued link between standard offer and default pricing is necessary for some transitional period. See, e.g., MECo Comments at 2; WMECo Comments at 2. The Legislature clearly indicated an intent that standard offer and default services be different in purpose and pricing. Moreover, the argument that the marketplace is not sufficiently mature to allow for a market-based default service is counterintuitive. Such an argument ignores the fact that the market cannot continue to

develop as long as default service – like standard offer service - remains in its current holding pattern, a pattern which PG&E Corporation ("PG&E") aptly notes has rendered default service a "sleeping giant." PG&E Comments at 1. Sithe believes that continued linkage of standard offer and default retail prices will only further forestall competitive development of retail and wholesale markets. The suggestion by some commenters that default customers should also benefit from below market prices (MECo Comments at 1; MEBC Comments at 1) ignores the fact that default service customers are more likely to have real competitive options once their retail electric rate is closer to market conditions. Moreover, the Attorney General, who represents retail ratepayers, has not raised the same concern and, in fact, has advocated a more market-based approach to default service. Attorney General Comments at 2. Sithe encourages the Department to take the opportunity now to implement changes that will allow default service to more accurately reflect market price.

3. Solicitation Process

Some commenters have agreed on the need to modify default service pricing to better reflect market prices, but disagree as to how a market price should be developed and how default service solicitations should be conducted. Because the provider of default service will incur costs that presumably will drive bids higher than the price of NEPOOL-ISO wholesale products, it would not appear appropriate to attempt to index default service exactly to wholesale prices of specific electricity products. However, the Department need not attempt to establish a proxy for market price. The Restructuring Act specifically provides that default service be procured through competitive bidding. Therefore, provided the solicitation process is established with certain safeguards (*e.g.*, reliability, creditworthiness), the bid process itself will establish a price that will represent market conditions. Internal costs to bidders would simply be reflected in their bid prices.

A number of comments have focused on the desire for either shorter or longer-term bid periods for provision of default service, to various ends. The Restructuring Act simply requires that bids include payment options with rates that remain uniform for periods of up to six months. Sithe endorses the proposed semi-annual procurement process and believes that solicitations every six months would allow distribution companies to procure a default price that correlates to current market conditions, but represents a sufficiently long-term as to encourage reasonable bid prices. Issuance of bids on a twice-yearly basis should not result in an undue administrative burden on the distribution company, particularly after some experience in the process is gained. Some commenters have suggested annual procurements of six-month default supplies. WMECo Comments at 4. Sithe encourages the Department to ensure that solicitations are made reasonably close in time to the time supply will be utilized, so that the bid can be reflective of current market conditions. A six-month bid supply period, with a corresponding fixed retail price will protect retail customers against extreme fluctuations in market conditions. Clearly, there is no perfect method to ensure a smooth transition for each and every retail customer. However, the Department has the means to introduce a market-based retail default service that will adequately protect customers from price risk and volatility, while at the same time encouraging retail competition in the marketplace.

III. CONCLUSION

In Sithe's view, this docket presents the Department with the chance to modify default service pricing, to the benefit of both market participants and customers. Sithe appreciates the

chance to offer its views on this important policy initiative and encourages the Department to take this opportunity to further enhance competitive options at the retail and wholesale levels.

Respectfully submitted,

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Dated: July 28, 1999